

The Best of Both Worlds: The Limited Liability Company

I. INTRODUCTION

In the past few years, state legislatures have shown a renewed interest in what is perhaps the most innovative form of business association, the limited liability company (LLC). The LLC combines the limited liability feature of the corporate form of association with the tax advantages of a partnership. The earliest states to enact LLC statutes were Wyoming in 1977 and Florida in 1982.¹

No other states took an immediate interest in this form of business association, primarily due to the uncertainty surrounding the Internal Revenue Service's (IRS) treatment of the LLC. The LLC was designed to provide flow-through tax advantages as in a partnership, but it was not officially known if the IRS would indeed honor such status. Recently, however, this difficulty was resolved and Colorado, Kansas, Virginia, Utah, Nevada and Texas have passed LLC Acts.² An ABA survey has reported that, in at least seven other states, including Arizona, California, Illinois, Maryland, Michigan, New Hampshire, and Oklahoma, LLC legislation has been introduced, and significant interest exists in another 25 states.³

Given the advantages of the LLC form of business association it is not surprising that it is gaining popularity. The limited liability feature allows

¹ *ABA Group Finds States Moving In Limited Liability Companies*, 23 SEC. REG. & LAW REP. 1275, 1275 (1991) [hereinafter *ABA Group*].

² *Id.* The LLC form of business association is not limited to the United States. Other countries include Bermuda, *see* General Atl. Inv. Ltd. v. Business Dev. Capital Ltd. Partnership, 620 F. Supp. 964 (S.D.N.Y. 1985); France, *see* Elizabeth Taylor Cosmetics Co. v. Annick Goutal, 673 F. Supp. 1238 (S.D.N.Y. 1987); Italy, *see* Gucci v. Gucci Shops, Inc., 688 F. Supp. 916 (S.D.N.Y. 1988); Lebanon, *see* Abu-Nassar v. Elders Futures, 1991 WL 45062 (S.D.N.Y.); Mexico, *see* MacGuire v. Commissioner, 450 F.2d 1239 (5th Cir. 1971); Netherlands, *see* Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264 (2d Cir. 1986); Nigeria, *see* Hester Int'l Corp. v. Federal Republic of Nigeria, 879 F.2d 170 (5th Cir. 1989); Saudi Arabia, *see* Arabian Trading & Chem. Indus. Co. v. B.F. Goodrich Co., 823 F.2d 60 (4th Cir. 1987); Switzerland, *see* Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir.), *cert. denied*, 469 U.S. 932 (1984); West Germany, *see* Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij, 173 F.2d 71 (2d Cir. 1949).

³ *ABA Group*, *supra* note 1, at 1275; *see also* *International Taxes, Field Support Unit, Litigation Process Examined by IRS Official*, DAILY REP. FOR EXECUTIVES, January 22, 1992, at 3.

individuals to support an LLC without becoming personally liable for its debts, as in a corporation.⁴ However, the corporate form trades such limited liability for the unfavorable double taxation structure.⁵ The LLC does away with this trade off and offers the more advantageous flow-through tax structure⁶ along with limited liability. This combination of characteristics may be found in other forms of business associations, such as the Subchapter S⁷ corporation and the limited partnership. However, the LLC is not subject to the restrictions placed on the former by the IRS, nor the requirement of a general partner in the latter.⁸

This Note is addressed primarily to those unfamiliar with the LLC form of business association. Part II will provide a developmental look at the LLC.⁹ The historical foundations, initial lack of popularity, and recent renewed interest in the LLC will be discussed. A survey of the eight current LLC Acts will make up Part III of the Note.¹⁰ This survey will analyze specific provisions in the different states relating to formation issues, financial matters, membership requirements, managerial concerns and dissolution procedures. These provisions will be analyzed by comparing and contrasting their similarities and differences, because, due to the newness of the LLC, it is impossible to determine fairly which provisions are superior. Part IV of the Note proposes that the LLC is a necessary form of business association given other available forms.¹¹ This section compares the LLC to both the Subchapter S corporation and the limited partnership. Finally, Part V discusses several issues that are yet to

⁴ A recent Treasury report urged federal legislatures to abandon the current two-tiered double taxation approach. Although the Treasury offered four options for restructuring the corporate tax system, it did not advance a particular legislative proposal. Until it does so, the system will likely remain the same. See Rita L. Zeidner, *Treasury Releases Long-Awaited Study Urging Corporate Integration*, 54 TAX NOTES 112, 112 (January 1992).

⁵ The entity's profits are taxed on the corporate level as corporate income and again when it is distributed to the shareholders in the form of dividends in cash or in kind, as shareholder income. Ernest A. Seemann, *The Florida Limited Liability Company: A New Form of Business Association*, 57 FLA. B. J. 536, 536 (Oct. 1983).

⁶ The income is taxed as income only when it is distributed to the individuals in proportion to their investments in the entity. *Id.*

⁷ A Subchapter S corporation is a corporation that has elected and has met the requirements set forth by the IRS to be taxed as a partnership. See I.R.C. §§ 1361-79 (1992).

⁸ *ABA Group*, *supra* note 1, at 1275.

⁹ See *infra* notes 13-44 and accompanying text.

¹⁰ See *infra* notes 45-105 and accompanying text.

¹¹ See *infra* notes 106-16 and accompanying text.

be resolved regarding the operation and enforcement of the LLC.¹² This format should provide the reader unfamiliar with the LLC with a basic understanding of this newest form and why it is gaining such support in legislatures across the United States.

II. A DEVELOPMENTAL LOOK AT THE LLC

A. *The First LLCs*

The first LLC statute appeared in 1977 in Wyoming.¹³ The Wyoming legislature enacted the statute in response to a need for a business association form bearing a lower tax burden than the corporate form, yet providing for more protection from liability than a limited partnership.¹⁴ However, the LLC was not widely accepted by the Wyoming business community; from its inception in 1977 through 1988, only twenty-six Wyoming LLCs were formed.¹⁵

Florida followed Wyoming's lead, and in 1982 the Florida Limited Liability Company Act was passed.¹⁶ The purpose behind the Florida LLC was to attract capital into the state.¹⁷ The legislature tried to attract international investors by providing a form of business association similar to the *limitada*¹⁸ form in Central and South America.¹⁹ It was thought that

¹² See *infra* notes 117-28 and accompanying text.

¹³ WYO. STAT. §§ 17-15-101 to 17-15-136 (1977).

¹⁴ Joseph P. Fonfara & Corey R. McCool, Comment, *The Wyoming Limited Liability Company: A Viable Alternative to the S Corporation and the Limited Partnership?*, 23 LAND & WATER L. REV. 523, 523-24 (1988). The first Wyoming LLCs were avenues for the exploration of oil and gas. They allowed the investors to avoid "potentially crushing liability claims." Adriel Bettelheim, *New Hybrid Corporate Entity Flourishing in Colo.*, DENVER POST, Nov. 18, 1991, at C1.

¹⁵ Fonfara & McCool, *supra* note 14, at 523.

¹⁶ FLA. STAT. ANN. § 608 (West Supp. 1992).

¹⁷ Richard Johnson, Comment, *The Limited Liability Company Act*, 11 FLA. ST. U. L. REV. 387, 387 (1983).

¹⁸ The *limitada* form of business association grants all members limited liability and can be structured to lack continuity of life and free transferability of interests. In essence, a *limitada* is structured like a partnership. This form has not been used extensively in the United States for several reasons. Namely, the *limitada* is hindered by capital restrictions, requirements that the members be natural persons, and uncertainty as to whether the American courts will honor the entity's limited liability feature. See Susan Pace Hamill, *The Limited Liability Company: A Possible Choice For Doing Business?*, 41 FLA. L. REV. 721, 722 n.9 (1989). In one instance the IRS has designated a Brazilian *limitada* as a partnership for tax purposes, however whether

foreign investors would more readily place their capital investments in Florida if they had a recognizable form of business association available.²⁰ The Florida legislature also wanted to provide a form of business association more attractive to domestic businesses: one which was unique and combined the advantages of various existing forms yet had few of the disadvantages.²¹ However, despite high expectations and the tangible advantages of the LLC, this new type of entity was rarely used by Florida businesses.²²

B. Apparent Reasons for the Lack of Popularity of the LLC

There are several reasons that contributed to the initial lack of popularity of the LLC, both with businesses throughout Florida and Wyoming as well as those in other states. First, the "difficulty in ascertaining the true character of the LLC and the resulting dependence of the LLC Act on the courts and the membership agreements to address issues not covered adequately by the statutes"²³ led to initial hesitation. Businesses feared constant litigation and the uncertainty of not knowing whether the courts would settle LLC disputes with partnership or corporation law. Second, there are no available entities similar to the LLC to provide businesses with a guideline as to the feasibility and potential of the form.²⁴ Given the risks surrounding the formation of new business associations, companies were understandably reluctant to be the first to pave the path toward common usage of the LLC.

The IRS showed initial hostility to the LLC, threatening to classify it as a corporation rather than a partnership for tax purposes.²⁵ In fact, in 1980, the IRS proposed a regulation that any entity that did not have a member with general liability, but did have associates and joint profit objectives, would be given the classification of a corporation.²⁶ These proposed amendments were never enacted; instead the IRS changed its

other foreign LLCs would receive the same treatment is uncertain. *See* Priv. Ltr. Rul. 80-03-072 (Oct. 25, 1979).

¹⁹ Johnson, *supra* note 17, at 387.

²⁰ *Id.*

²¹ *See id.*

²² *See id.* at 388.

²³ *Id.* at 394.

²⁴ *Id.*

²⁵ Hamill, *supra* note 18, at 722 n.7; *see* Johnson, *supra* note 17, at 394.

²⁶ *See* 45 Fed. Reg. 75709-01 (1980) (proposed at 26 C.F.R. §§ 301.7701-2) (proposed Nov. 17, 1980); Johnson, *supra* note 17, at 396.

stance on the issue and, in 1988, issued a ruling classifying a Wyoming LLC as a partnership for tax purposes.²⁷

Given the uncertainties surrounding the LLC, it is not surprising that most companies concluded that the risks involved with the LLC were not worth taking. With these serious justifications for hesitations, it seemed at first that the LLC would amount to no more than a wasted effort on the part of the Florida and Wyoming legislatures.

C. Renewed Interest in the LLC

Although several of the problems discussed above²⁸ are still present, the most significant difficulty—the hostility of the IRS—has been practically eliminated with a 1988 Revenue Ruling proclaiming that a Wyoming LLC would be treated as a partnership for tax purposes.²⁹

To determine if the Wyoming LLC is a corporation or a partnership for tax purposes, the IRS began with the continuity of life characteristic. If the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, continuity of life

²⁷ See *infra* note 29 and accompanying text.

²⁸ See *supra* notes 23–27 and accompanying text.

²⁹ Rev. Rul. 88-76, 1988-2 C.B. 360. The Internal Revenue Code prescribes various classifications including associations, partnerships and trusts, into which a business organization must fit for taxation purposes. Treas. Reg. § 301.7701-1(b) (as amended in 1977). Whether an organization is considered an association (taxed as a corporation) or a partnership for tax purposes depends on whether it has more corporate characteristics than partnership characteristics. Treas. Reg. § 301.7701-2(a)(3) (as amended in 1977). The corporate characteristics include: having associates, an objective to carry on business and divide the profits and losses thereof, continuity of life, centralization of management, liability for corporate debts limited to corporate property and free transferability of interests. Treas. Reg. § 301.7701-2(a)(1) (as amended in 1977). The partnership form of business also includes some of the above characteristics, such as associates and an objective to carry on business for profit. Given the similarities between the corporation and partnership forms, the IRS has ruled that the characteristics that are common to both organizations are not to be used to determine which form prevails. See Treas. Reg. § 301.7701-2(a)(3) (as amended in 1977). Therefore, only centralized management (corporation) or lack thereof (partnership), free transferability of interests (corporation) or lack thereof (partnership), continuity of life (corporation) or lack thereof (partnership) and limited liability (corporation) or lack thereof (partnership) are considered in the classification determination. The IRS recently applied these four basic characteristics to a Wyoming LLC and determined that the partnership characteristics prevailed and the LLC would be classified as a partnership.

does not exist.³⁰ The IRS found that the typical Wyoming LLC does not contain the continuity of life characteristic of a corporation. The LLC statute provides for an agreement that, in essence, makes the LLC's dissolution temporary following a death or withdrawal and facilitates a subsequent reorganization of the business if all remaining members consent. Strictly speaking, the dissolution is not prevented and there is no continuity of life.

Furthermore, it was determined that the corporate characteristic of free transferability of interests is not present with the Wyoming LLC.³¹ Under the Wyoming Act, a member of the LLC can assign his or her interest in the organization to another. However, that assignee fails to become a substitute member and does not receive all of the attributes of the original member's interest unless other participants in the LLC consent to the assignment or transfer.³²

On the other hand, two corporate characteristics were present in the LLC: centralized management³³ and limited liability.³⁴ Under the Wyoming Act, the typical LLC is managed by designated managers that constitute less than all of the members and therefore, centralized management exists.³⁵ Also, the IRS determined that in Wyoming LLCs, the individual members are not personally liable for the organization's

³⁰ Treas. Reg. § 301.7701-2(b)(2) (as amended in 1977).

³¹ An organization has free transferability of interest if its members have the power without the consent of the others to substitute another for their position in the LLC. For the power of substitution to exist, a member must be able to confer on the assignee all of the attributes of his interest in the organization. There is no free transferability of interest if the individual members have the power to transfer the right to profits but not the power to transfer the right to participate in the management of the organization without the others' consent. Treas. Reg. § 301.7701-2(e)(1) (as amended in 1977).

³² Rev. Rul. 88-76, 1988-2 C.B. 361.

³³ The regulation provides that an organization has the corporate characteristic of centralized management if any person or group of persons that does not constitute all of the members has continuing exclusive authority to make management decisions necessary to the conduct of the business for which the organization was formed. Treas. Reg. § 301.7701-2(c)(1) (as amended in 1977).

³⁴ The regulations provide that an organization has the corporate characteristic of limited liability if under local law there is no member who is personally liable for the debts of, or claims against, the organization. Personal liability exists if a creditor of an organization may seek personal payment from an individual member of the organization to the extent that the organization cannot meet the creditor's claim. Treas. Reg. § 301.7701-2(d)(1) (as amended in 1977).

³⁵ Rev. Rul. 88-76, 1988-2 C.B. 361.

debts and obligations so that the corporate characteristic of limited liability exists.³⁶

Overall, the LLC was found to possess the characteristics of limited liability and centralized management, indicating that it should be taxed as a corporate association, but lacked free transferability of interests and continuity of life, indicating that it should be taxed as a partnership with flow-through profits. The IRS ruled that since a majority of corporate characteristics were not present, the Wyoming LLC would be classified as a partnership for tax purposes.³⁷ This ruling "really made the concept take off."³⁸ In 1990, Colorado became the third state to adopt legislation providing for the creation of LLCs³⁹ and Kansas became the fourth.⁴⁰ Virginia and Utah followed suit and adopted legislation on March 12, 1991 and March 18, 1991 respectively.⁴¹ Nevada and Texas⁴² passed LLC legislation late in 1991. This renewed interest in the LLC indicates that businesses and legislatures feel confident that other states' LLCs will be classified similarly. Although the IRS has not issued official revenue

³⁶ *Id.*

³⁷ *Id.*

³⁸ Daniel B. Moskowitz, *New Way to Organize Business Is Gaining Wider Acceptance*, WASH. POST, Nov. 4, 1991, at F14.

³⁹ As of November 1991, more than 550 LLCs have been formed in Colorado. The state's professionals report that the LLC is beginning to surpass partnerships as the preferred entity for small businesses and joint ventures. Buttelheim, *supra* note 14, at C1.

⁴⁰ An issue seemingly particular to Kansas is whether interests in LLCs will be deemed securities under the Kansas Securities Act. *Legislative Briefs, Kansas* 23 SEC. REG. & LAW REP. 778 (1991). A parallel concern on the federal level is discussed in Part V of this Comment. *See infra* notes 124-25 and accompanying text.

⁴¹ Brian L. Schorr & Aileen R. Leventon, *Limited Liability Company: An Alternative Business Form*, N.Y. L.J., May 30, 1991, at 1. The State of Utah's Division of Corporations Director, Peter Van Alstyne, reportedly believed that "state regulators worked closely with the IRS in drafting the bill" and he anticipated that the Service would approve the new bill. Van Alstyne also stated that the LLC is going to attract business to the state, and is part of its efforts to make it easier for businesses to form, capitalize and thrive. *Utah*, DAILY REP. FOR EXECUTIVES, May 24, 1991, at H-9.

⁴² The Texas legislation is "designed to encourage business formation in the state by giving such companies certain tax and other advantages." *See Texas*, DAILY REP. FOR EXECUTIVES, July 19, 1991, at H-6.

rulings on the classification of LLCs in other states,⁴³ it has given several private letter rulings treating them as partnerships.⁴⁴

III. A SURVEY OF THE BASIC LLC STATUTORY PROVISION

A. *Formation of the LLC*

In most states an LLC may be formed for any lawful purpose,⁴⁵ but in a few states banking and insurance industries are excepted⁴⁶ as well as professional services.⁴⁷ Several other acts expressly limit the purposes of an LLC to those permitted for a corporation or partnership.⁴⁸ In general, the purposes permitted for an LLC are as broadly defined as most other business associations, perhaps to allow the companies forming LLCs as much latitude as with other forms and to prevent purposes from becoming a hindrance to LLC popularity.

Like the broad purpose provisions, the statutes carefully provide the LLC with a broad range of basic powers and in a few instances, additional secondary powers. The basic powers found in the LLC Acts give the organization the power to sue and be sued; deal in property; lend money for proper purposes; deal in shares, interests, or obligations of other LLCs, corporations, partnerships, the United States government or any nation; make contracts and guarantees and incur liabilities; conduct its business in any state in the United States; elect or appoint managers and

⁴³ The delay is said to be "partly due to slow-moving bureaucracy at the IRS and partly because of the unusual way LLCs treat income and deductions." See Bettelheim, *supra* note 14, at C1.

⁴⁴ See, e.g., Priv. Ltr. Rul. 90-52-039 (Oct. 2, 1990); Priv. Ltr. Rul. 90-30-013 (Apr. 25, 1990).

⁴⁵ COLO. REV. STAT. ANN. § 7-80-103 (West Supp. 1990); FLA. STAT. ANN. § 608.403 (West Supp. 1992); KAN. STAT. ANN. § 17-7603 (Supp. 1992); NEV. REV. STAT. ANN. § 86.141 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.01 (Vernon); UTAH CODE ANN. § 48-2b-104 (1992); VA. CODE ANN. § 13.1-1008 (Michie Supp. 1992); WYO. STAT. § 17-15-103 (1977).

⁴⁶ NEV. REV. STAT. ANN. § 86.141 (Michie Supp. 1991); WYO. STAT. § 17-15-103 (1977).

⁴⁷ VA. CODE ANN. § 13.1-1008 (Michie Supp. 1992). Recently, the American Institute of Certified Public Accountants approved a change that will allow CPA firms to organize as LLCs. However, this change may have little effect because only Hawaii, Colorado, Wyoming and Kansas allow such a firm to organize as an LLC. *AICPA Members Okay Proposal To Permit CPA Firms To Organize As Corporations*, DAILY REP. FOR EXECUTIVES, January 16, 1992, at A-12.

⁴⁸ COLO. REV. STAT. ANN. § 7-80-103 (West Supp. 1991); KAN. STAT. ANN. § 17-7603 (Supp. 1991); UTAH CODE ANN. § 48-2b-104 (1992).

agents; make and alter operating agreements; cease its activities; dispose of its property or assets; and exercise all powers "necessary or convenient to effect any of the purposes for which the company is organized."⁴⁹

Some states have expressly enumerated additional secondary powers such as the power to indemnify,⁵⁰ pay compensation,⁵¹ insure,⁵² lend money to assist members,⁵³ donate to charities,⁵⁴ pay pensions,⁵⁵ and become a promoter.⁵⁶ In those states which do not enumerate these powers, whether the LLC implicitly has them will officially depend upon the resolution of such issues in the individual states, using state corporation law. However, given the importance of many of the functions, such as paying compensation, securing insurance, etc., it is most likely that these secondary powers will be considered implied powers. Only the state of Utah specifically gives its LLCs the power to render professional services with certain limitations,⁵⁷ and only the state of Texas simplifies its listing of powers by stating that each LLC has the same powers as those that are listed for a corporation and a limited partnership under other sections of the Texas Code.⁵⁸

Most of the provisions given above are similar to those granted to corporations and partnerships, and they should be. First, such similarities

⁴⁹ NEV. REV. STAT. ANN. § 86.281 (Michie Supp. 1991). *See also* COLO. REV. STAT. ANN. § 7-80-104 (West Supp. 1991); FLA. STAT. ANN. § 608.404 (West Supp. 1992); KAN. STAT. ANN. § 17-7604 (Supp. 1991); UTAH CODE ANN. § 48-2b-105 (1992); VA. CODE ANN. § 13.1-1009 (Michie Supp. 1992); WYO STAT. § 17-15-104 (1977).

⁵⁰ FLA. STAT. ANN. § 608.405(11) (West Supp. 1992); KAN. STAT. ANN. § 17-7604(j) (Supp. 1991); UTAH CODE ANN. § 48-2b-105(1)(l) (1992); VA. CODE ANN. § 13.1-1009 (Michie Supp. 1992); WYO. STAT. § 17-15-104(a)(xi) (1977).

⁵¹ VA. CODE ANN. § 13.1-1009(12) (Michie Supp. 1992).

⁵² VA. CODE ANN. § 13.1-1009(13) (Michie Supp. 1992).

⁵³ NEV. REV. STAT. ANN. § 86.281(4) (Michie Supp. 1991), UTAH CODE ANN. § 48-2b-105(1)(d) (1992); WYO. STAT. § 17-15-104(a)(iv) (1977).

⁵⁴ FLA. STAT. ANN. § 608.404(10) (West Supp. 1992); KAN. STAT. ANN. § 17-7604(i) (Supp. 1991); UTAH CODE ANN. § 48.2b-105(k) (1992); VA. CODE ANN. § 13.1-1009(10) (Michie Supp. 1992).

⁵⁵ FLA. STAT. ANN. § 608.405(15) (West Supp. 1992); KAN. STAT. ANN. § 17-7604(n) (Supp. 1991); UTAH CODE ANN. § 48-2b-105(1)(p) (1992); VA. CODE ANN. § 13.1-1009(9) (Michie Supp. 1992).

⁵⁶ FLA. STAT. ANN. § 608.404(16) (West Supp. 1982); KAN. STAT. ANN. § 17-7604(o) (Supp. 1991); UTAH CODE ANN. § 48-2b-105(1)(q) (1992).

⁵⁷ UTAH CODE ANN. § 48-2b-105(1)(r) (1992). Any LLCs organized to render professional services are limited to one area of service and are not permitted to engage in any other business other than that service. UTAH CODE ANN. § 48-2b-105(2) (1992).

⁵⁸ 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.02 (Vernon).

are more attractive to companies considering the LLC form because they are familiar with their everyday operation. Second, even if disputes arise concerning those provisions, courts and parties alike may be able to treat the LLC similar to existing entities with very little alteration. Of course, whether this will happen remains to be seen, for it is possible that an entire new body of state law may emerge, treating the LLC uniquely. Finally, these similarities keep LLCs on an even playing field with corporation and partnership forms and facilitate their development.

In accordance with most state corporation law requiring an indication that an entity is a corporation, LLC laws require LLCs to conform their names to specific guidelines. In all statutes, either the words "limited liability company,"⁵⁹ "limited company"⁶⁰ or the abbreviation "L.C."⁶¹ must appear in the name of the organization. Some states allow the names to be reserved in advance of the LLC's inception⁶² and others are stricter in that they provide for unlimited liability if the proper name is not used.⁶³ Although such guidelines may seem trivial, they are, in fact, necessary to ensure that those parties dealing with the LLC are notified of its limited liability feature. Because the form looks and acts much like a partnership, it is essential that those creditors in contact with an LLC are aware of the limits on their ability to collect debts against members. Such a notion is consistent with the importance in our legal system of the concept of fair notice.

The formalities for an LLC are practically the same in all of the Acts with few minor technical differences. In most states, two or more persons are needed to form an LLC,⁶⁴ and in some, only one person over the age

⁵⁹ COLO. REV. STAT. ANN. § 7-80-201 (West Supp. 1991); NEV. REV. STAT. ANN. § 86.171 (Michie Supp. 1991) (Limited-Liability Company); WYO. STAT. § 17-15-105 (1977).

⁶⁰ FLA. STAT. ANN. § 608.406 (West Supp. 1992); KAN. STAT. ANN. § 17-7606 (Supp. 1991); UTAH CODE ANN. § 48-2b-108 (1992); VA. CODE ANN. § 13.1-1012 (Michie Supp. 1992).

⁶¹ 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.03 (Vernon).

⁶² COLO. REV. STAT. ANN. § 7-80-202 (West Supp. 1991); NEV. REV. STAT. ANN. § 86.171(4) (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.04 (Vernon); UTAH CODE ANN. § 24-2b-106(4) (1992); VA. CODE ANN. § 13.1-1013 (Michie Supp. 1992).

⁶³ FLA. STAT. ANN. § 608.406(2) (West Supp. 1992); KAN. STAT. ANN. § 17-7606(b) (Supp. 1991); NEV. REV. STAT. ANN. § 86.171(2) (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-108 (1992); WYO. STAT. § 17-15-105(b) (1977).

⁶⁴ FLA. STAT. ANN. § 608.405 (West Supp. 1992); KAN. STAT. ANN. § 17-7605 (Supp. 1991); NEV. REV. STAT. ANN. § 86.151 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-103 (1992); WYO. STAT. § 17-15-106 (1977).

of eighteen is needed to organize it.⁶⁵ In all states Articles of Organization must be filed with the secretary of state which include the LLC's name and period of duration.⁶⁶ Many Acts require that the LLC's period of duration must not be for more than 30 years.⁶⁷ The reason for this limitation may be to ensure that the organization does not have endless continuity of life. Generally, an LLC is deemed organized either upon endorsement by the members of the Articles,⁶⁸ upon filing of the Articles,⁶⁹ or upon the issuance by the secretary of state of a Certificate of Organization.⁷⁰ In all cases, there are statutory provisions for amending the Articles of Organization.⁷¹ Comparatively, it is equally simple to form an LLC or a corporation. However, it would be wise for members of LLCs to proceed carefully because there is no indication of how the courts will handle any deficiencies or resolve any disputes that arise in the LLC formation process.

⁶⁵ COLO. REV. STAT. ANN. § 7-80-203 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 3.01 (Vernon).

⁶⁶ COLO. REV. STAT. ANN. § 7-80-204 (West Supp. 1991); FLA. STAT. ANN. § 608.407 (West Supp. 1992); KAN. STAT. ANN. § 17-7607 (Supp. 1991); NEV. REV. STAT. ANN. § 86.161 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 3.02 (Vernon); UTAH CODE ANN. § 48-2b-116 (1992); VA. CODE ANN. § 13.1-1011 (Michie Supp. 1992); WYO. STAT. § 17-15-107 (1977). Other provisions that may be included in the Articles of Organization include the purpose of the LLC, the address of its principal place of business or name and address of its registered agent, or both, the total amount of capital contributions and any additional contributions, the members' rights to add to the membership and continuation rights, and if the LLC will be managed by managers, the names and addresses of those managers. *See* COLO. REV. STAT. ANN. § 7-80-204 (West Supp. 1991); FLA. STAT. ANN. § 608.407 (West Supp. 1992); KAN. STAT. ANN. § 17-7607 (Supp. 1991); NEV. REV. STAT. ANN. § 86.161 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 3.02 (Vernon); UTAH CODE ANN. § 48-2b-116 (1991); VA. CODE ANN. § 13.1-1011 (Michie Supp. 1992); WYO. STAT. § 17-15-107 (1977).

⁶⁷ COLO. REV. STAT. ANN. § 7-80-204 (West Supp. 1991); NEV. REV. STAT. ANN. § 86.161(1)(b) (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 3.02 (Vernon); WYO. STAT. § 17-15-107(a)(ii) (1977).

⁶⁸ NEV. REV. STAT. ANN. § 86.201 (Michie Supp. 1991).

⁶⁹ COLO. REV. STAT. ANN. § 7-80-207 (West Supp. 1991); KAN. STAT. ANN. § 17-7609 (Supp. 1991); UTAH CODE ANN. § 48-2b-117 (1992).

⁷⁰ FLA. STAT. ANN. § 608.409 (West Supp. 1992); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 3.04 (Vernon); WYO. STAT. § 17-15-109 (1977).

⁷¹ COLO. REV. STAT. ANN. § 7-80-209 (West Supp. 1991); FLA. STAT. ANN. § 608.411 (West Supp. 1992); KAN. STAT. ANN. § 17-7610 (Supp. 1991); NEV. REV. STAT. ANN. § 86.221 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 3.05 (Vernon); UTAH CODE ANN. § 48-2b-121 (1992); VA. CODE ANN. § 13.1-1014 (Michie Supp. 1992); WYO. STAT. § 17-15-107 (1977).

B. *Members of the LLC*

It is universally accepted that the interests of members of an LLC are characterized as personal property.⁷² This property is protected by some provisions that are typical for corporate shareholder interests, and others that are aligned with a partner's interest in a partnership. In all LLC Acts, there is a general provision stating that no members or managers shall be liable "under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the limited liability company."⁷³ This corporate-like protection is what grants the LLC its most coveted characteristic: its limited liability.

Other provisions tend to be more partnership oriented, such as those relating to the addition of members to the LLC membership. In all states except Wyoming, a member may transfer or assign his interest in the LLC. However, if the nontransferring members do not consent unanimously⁷⁴ in writing, the assignee or transferee has no right to become a member or to participate in the business or management of the LLC.⁷⁵ Rather they are only entitled to profits or other compensation in the form of income equal to the amount to which the transferor or assignor was entitled.⁷⁶ If,

⁷² COLO. REV. STAT. ANN. § 7-80-702 (West Supp. 1991); FLA. STAT. ANN. § 608.431 (West Supp. 1992); KAN. STAT. ANN. § 17-7617 (Supp. 1991); NEV. REV. STAT. ANN. § 86.351 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 4.04 (Vernon); UTAH CODE ANN. § 48-2b-103 (1992); VA. CODE ANN. § 13.1-1038 (Michie Supp. 1992).

⁷³ COLO. REV. STAT. ANN. § 7-80-705 (West Supp. 1991); FLA. STAT. ANN. § 608.436 (West Supp. 1992); KAN. STAT. ANN. § 17-7620 (Supp. 1991); NEV. REV. STAT. ANN. § 86.371 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-109 (1992); WYO. STAT. § 17-15-113 (1977); *see also* 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 4.03 (Vernon); VA. CODE ANN. § 13.1-1019 (Michie Supp. 1992).

⁷⁴ The unanimous consent requirement is the rule in all states except Utah, where the statute requires that the nontransferring members who are entitled to receive a majority of the LLC's profits must consent. UTAH CODE ANN. § 48-2b-131 (1992).

⁷⁵ COLO. REV. STAT. ANN. § 7-80-702 (West Supp. 1991); FLA. STAT. ANN. § 608.432 (West Supp. 1992); KAN. STAT. ANN. § 17-7618 (Supp. 1991); NEV. REV. STAT. ANN. § 86.351 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 4.05, 4.07 (Vernon); VA. CODE ANN. § 13.1-1039-1040 (Michie Supp. 1992).

⁷⁶ COLO. REV. STAT. ANN. § 7-80-702 (West Supp. 1991); FLA. STAT. ANN. § 608.432 (West Supp. 1992); KAN. STAT. ANN. § 17-7618 (Supp. 1991); NEV. REV. STAT. ANN. § 86.351 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 4.05 (Vernon); UTAH CODE ANN. § 48-2b-131 (1992); VA. CODE ANN. § 13.1-1039-1040 (Michie Supp. 1992).

however, the nontransferring members do give their unanimous consent, the assignee has a right to become a member.⁷⁷ Furthermore, some states provide a provision that in order to add members, other than through assignment or transfer, the unanimous consent of all existing members is needed.⁷⁸ Such guidelines protect the existing members of an LLC from unfavorable changes in the makeup of the membership, as in a partnership. This protection is especially important when the members of the LLC are greatly interdependent and there is no ready market in which to transfer interests in the LLC.

One additional provision relating to the individual creditors of the members of the LLC is also popular in LLC statutes. It is noted in almost every state that such creditors may, through a proper court, charge the members interest in the LLC to the extent that the member is in debt to the creditor.⁷⁹ However, it should be noted that such a process is treated as an assignment.⁸⁰

C. *Financial Matters in the LLC*

The typical LLC statutes cover two basic categories of financial matters: the capital contribution of the LLC's members and the distribution/sharing of profits and losses. First, in the majority of states, the members may make their capital contributions in the form of cash, property, services rendered, or promissory note (or other obligation) to contribute cash, property or services in the future.⁸¹ However, in the earliest LLC Acts (Wyoming and Florida), the form of contribution is limited to only cash or property, not services,⁸² indicating that if a member performs services for the LLC those services must be in addition to the capital contribution and should be paid for by the LLC, similar to income or wages. This partnership-like limitation is harmful to those companies with some individual members who are unable to contribute personal assets

⁷⁷ See statutes cited *supra* note 76.

⁷⁸ COLO. REV. STAT. ANN. § 7-80-701 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 4.01 (Vernon).

⁷⁹ COLO. REV. STAT. ANN. § 7-80-703 (West Supp. 1991); NEV. REV. STAT. ANN. § 86.401 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 4.06 (Vernon); VA. CODE ANN. § 13.1-1041 (Michie Supp. 1992).

⁸⁰ See *supra* notes 74-78 and accompanying text.

⁸¹ COLO. REV. STAT. ANN. § 7-80-501 (West Supp. 1991); NEV. REV. STAT. ANN. § 86.321 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 5.01 (Vernon); UTAH CODE ANN. § 48-2b-124 (1992).

⁸² FLA. STAT. ANN. § 608.4211 (West Supp. 1992); WYO. STAT. § 17-15-115 (1977).

other than services, which is the case in many small start-up businesses. In such cases, the members unable to give assets other than services are limited to being employees of the business at first, but can later be brought into the LLC after accumulating the required capital in the required form.

Once the LLC member has made the required capital contribution, most states impose certain restrictions on the member's right to have that contribution returned by the LLC.⁸³ For example, members are not entitled to any part of their capital contribution until (1) all liabilities except members' contributions are either paid or covered by the fair value of the LLC's remaining assets, (2) all members consent, unless the member is otherwise rightfully entitled to a return of the contribution due to dissolution, the arrival of a specified date in the Articles of Organization, or the completion of 6 months advance notice of withdrawal, and (3) the Articles of Organization are amended to reflect the reduction in capital.⁸⁴ Other states provide generally that the disbursement of capital contributions, as well as any other distributions, is not permitted if the fair market value of the LLC is less than its liabilities less capital contributions.⁸⁵ Either limitation supports the limited liability notion of the LLC; although members are not personally liable for debts of the organization, their capital contributions become part of the LLC's property and may be used to pay creditors.

One additional provision common to most LLC Acts provides that no member is entitled to demand and receive either a capital contribution or any distribution, in any form except cash.⁸⁶ This notion supports the continuation rights of remaining members once an exiting member demands his or her capital contribution. Since the exiting member has no right to exit with anything but cash, it is more likely that the remaining entity will be able to carry on business as usual.

⁸³ COLO. REV. STAT. ANN. § 7-80-606 (West Supp. 1991); FLA. STAT. ANN. § 608.426 (West Supp. 1992); KAN. STAT. ANN. § 17-7615-16 (Supp. 1991); NEV. REV. STAT. ANN. § 86.331 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 5.09 (Vernon); UTAH CODE ANN. § 48-2b-132 (1992); VA. CODE ANN. § 13.1-1035 (Michie Supp. 1992); WYO. STAT. § 17-15-120 (1977).

⁸⁴ FLA. STAT. ANN. § 608.427 (West Supp. 1992); KAN. STAT. ANN. § 17-7616 (Supp. 1991); NEV. REV. STAT. ANN. § 86.331 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-132 (1992); WYO. STAT. § 17-15-120 (1977).

⁸⁵ COLO. REV. STAT. ANN. § 7-80-606 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 5.09 (Vernon); VA. CODE ANN. § 13.1-1035 (Michie Supp. 1992).

⁸⁶ COLO. REV. STAT. ANN. § 7-80-604 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 5.07 (Vernon); UTAH CODE ANN. § 48-2b-132 (1992); VA. CODE ANN. § 13.1-1034 (Michie Supp. 1992); WYO. STAT. § 17-15-120 (1977).

The LLC statutes provide for other distribution procedures. Most of the Acts expressly allow for the sharing of profits and losses according to either the LLC regulations or operating agreement.⁸⁷ Others go further and give the same guideline for the distribution of LLC real property, cash and/or other assets.⁸⁸ In the case that either the regulations or operating agreement fail to mention distribution issues, the Acts provide that distributions should be made according to the fair value of the member's interest in the LLC.⁸⁹ And again, as with distribution of capital contributions, distribution of LLC real property, assets and/or cash, the rule remains that no distributions can be made if, after disbursement, the LLC will not be able to meet its liabilities with its fair market value.⁹⁰

One final interesting provision can be found in a few LLC Acts. Colorado and Virginia provide that once a member "becomes entitled to receive a distribution, he or it has the status of, and is entitled to all remedies available to, a creditor of the limited liability company with respect to the distribution."⁹¹ Such a provision provides extra protection for LLC members, to help guarantee that anything owed to them, with the possible exception of capital contributions, will be paid on an equal basis with other creditors. Overall, the financial matters set forth in the LLC Acts are very generalized and rely to a great degree on what the members provide in either the Articles of Incorporation or the LLC regulations.

D. Management of the LLC

The LLC Acts provide for two types of LLC management provisions with few variations. The basic form, which appears in the majority⁹² of the states, simply states three general propositions. First, they provide that

⁸⁷ COLO. REV. STAT. ANN. § 7-80-503 (West Supp. 1991); NEV. REV. STAT. ANN. § 86.341 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 5.03 (Vernon); UTAH CODE ANN. § 48-2b-130 (1992); VA. CODE ANN. § 13.1-1029 (Michie Supp. 1992); WYO. STAT. § 17-15-119 (1977).

⁸⁸ See COLO. REV. STAT. ANN. § 7-80-504 (West Supp. 1991); FLA. STAT. ANN. § 608.426 (West Supp. 1992); KAN. STAT. ANN. § 17-7615 (Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 5.02 (Vernon); UTAH CODE ANN. §§ 48-2b-128 to 48-2b-129 (1992); VA. CODE ANN. § 13.1-1030 (Michie Supp. 1992).

⁸⁹ See *supra* notes 87-88.

⁹⁰ See *supra* notes 83-85 and accompanying text.

⁹¹ COLO. REV. STAT. ANN. § 7-80-605 (West Supp. 1991); VA. CODE ANN. § 13.1-1037 (Michie Supp. 1992).

⁹² FLA. STAT. ANN. § 608.422 (West Supp. 1992); KAN. STAT. ANN. § 17-7612 (Supp. 1991); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-125 (1992); WYO. STAT. § 17-15-116 (1977).

unless otherwise provided for in the Articles of Organization, management powers are vested in the members of the LLC in proportion to their contributions to capital.⁹³ Such a rule supports the general conclusion that the state legislature meant to give the members the right to opt out of management powers and, if they did not choose to do so, those that provided more capital would receive more power. The former indicates the overwhelming willingness of the legislatures to provide freedom to members of the LLC and the latter ensures that those who have more at stake will have more power to control, rather than power equal to all others.

Second, these statutes provide that if the members choose not to retain the power to manage, they will still control management processes indirectly by electing those that will perform management duties for them.⁹⁴ Such management form compares more to partnership management in that most partnerships can either elect to manage themselves or choose those who will do so for them. However, as noted earlier, the IRS has determined that LLCs possess the corporate characteristic of centralized management.⁹⁵ This conclusion is only supported if the members choose to opt out of management responsibilities. If not, it is unlikely that the IRS is justified in assigning the characteristic of centralization of management to an LLC. The facts of each particular organization will control.

Third, the basic management structure provides that the managers shall "hold the offices and have the responsibilities accorded to them by the members and set out in the operating agreement."⁹⁶ This provision parallels those given in corporation and partnership legislation, and indicates the willingness of the legislature to give the LLC members virtually free reign in determining what offices and responsibilities are assigned to the managers.

Three states provide a more detailed format for LLC management. The requirements of those states differ from the provisions above in that

⁹³ FLA. STAT. ANN. § 608.422 (West Supp. 1992); KAN. STAT. ANN. § 17-7612 (Supp. 1991); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-125 (1992); VA. CODE ANN. § 13.1-1022 (Michie Supp. 1992); WYO. STAT. § 17-15-116 (1977).

⁹⁴ FLA. STAT. ANN. § 608.422 (West 1992); KAN. STAT. ANN. § 17-7612 (Supp. 1991); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-125 (1992); VA. CODE ANN. § 13.1-1024 (Michie Supp. 1992); WYO. STAT. § 17-15-116 (1977).

⁹⁵ See *supra* note 35 and accompanying text.

⁹⁶ FLA. STAT. ANN. § 608.422 (West Supp. 1992); KAN. STAT. ANN. § 17-7612 (Supp. 1991); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-125 (1992); WYO. STAT. § 17-15-116 (1977).

management powers are presumed to be vested in managers with a possibility for the members to opt out of the provision.⁹⁷ Obviously, the LLC managers in these states are governed more closely by the state statutes than the LLC membership itself.

E. Dissolution of an LLC

The LLC statutes provide for both voluntary and involuntary dissolution. An LLC is voluntarily dissolved upon the occurrence of a

⁹⁷ COLO. REV. STAT. ANN. § 7-80-401 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.12 (Vernon). There are additional provisions providing for the number of managers. Generally, the number of initial managers is fixed by the Articles of Organization, and the number of continuing managers may also be provided in the operating agreement. *See* COLO. REV. STAT. ANN. § 7-80-402 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.13 (Vernon); VA. CODE ANN. § 13.1-1024 (Michie Supp. 1992). Some LLC statutes dictate the managers' term of office. The default term of office is one year, from annual meeting to annual meeting. *See* COLO. REV. STAT. ANN. § 7-80-402 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.13 (Vernon); VA. CODE ANN. § 13.1-1024 (Michie Supp. 1992). However, two states provide that when the number of managers is large, the members may provide that fewer than all managers will be elected in a single year, to facilitate what are normally called staggered elections. *See* COLO. REV. STAT. ANN. § 7-80-403 (West Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.13 (Vernon). Some provisions give the procedure for filling vacancies in management. In one state, vacancies are filled either by majority of remaining managers or by election at an annual or special meeting by the members. 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.15 (Vernon). In two other states, vacancies are filled by majority vote of the remaining managers rather than through member participation. *See* COLO. REV. STAT. ANN. § 7-80-404 (West Supp. 1991). Provisions in these states also define what constitutes a quorum for election purposes. A majority of managers is a quorum unless otherwise provided in the Articles of Organization or operating agreement and an action by the majority of managers constituting a quorum is considered an action of all managers. *See* 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.16 (Vernon). The procedure for the removal of managers is also dictated in these provisions. Fewer than all or all managers may be removed with or without cause or as provided by the Articles of Organization or operating agreement. *See* COLO. REV. STAT. ANN. § 7-80-405 (West Supp. 1991); VA. CODE ANN. § 13.1-1024 (Michie Supp. 1992). The duties and standards of conduct for managers are also provided. *See* COLO. REV. STAT. ANN. § 7-80-406 (West Supp. 1991); VA. CODE ANN. § 13.1-1024.1 (Michie Supp. 1992). Finally, the provisions for governing interested director activities are listed. *See* 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 2.17 (Vernon).

"dissolution event."⁹⁸ Once this event has occurred, there are three alternatives among the LLC statutes for continuation of the business.⁹⁹ In Colorado, Wyoming, and Virginia the LLC may be continued by the unanimous consent of all remaining members.¹⁰⁰ A second alternative method for continuation is given in Florida and Kansas where the LLC may be continued upon unanimous consent or under a right to continue in the Articles of Organization.¹⁰¹ Finally, Utah law allows an LLC to continue by consent of the remaining members who would receive the majority of the LLC's capital were it dissolved.¹⁰² These alternatives are the determining factor in deciding whether the corporate characteristic of continuity of life exists for an LLC. When drafting LLC provisions, it should be kept in mind that the entity must technically dissolve upon the happening of a dissolution event in order to defeat the continuity of life characteristic. If it does not, the corporate characteristic exists and it is possible that the IRS will classify the LLC as a corporation rather than a partnership.¹⁰³

Involuntary dissolution is also provided for in four of the eight LLC statutes. Florida, Kansas, and Utah all provide that an LLC may be dissolved involuntarily when it is established that it procured its Articles through fraud, continued to exceed or abuse its legal authority, committed a violation of law that requires forfeiture of its charter, or has abused its powers contrary to the state's public policy.¹⁰⁴ Colorado differs in that it allows involuntary dissolution when it is established that an LLC procured its articles through fraud, continued to exceed or abuse its legal authority,

⁹⁸ A dissolution event may be the expiration of the fixed duration of the LLC, the unanimous written agreement of all members, or upon death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member, or any other event which terminated the continued membership of a member. *See* COLO. REV. STAT. ANN. § 7-80-801 (West Supp. 1991); FLA. STAT. ANN. § 608.441 (West Supp. 1992); KAN. STAT. ANN. § 17-7622 (Supp. 1991); NEV. REV. STAT. ANN. § 86.491 (Michie Supp. 1991); 1991 TEX. SESS. LAW SERV. ch. 901, § 46, art. 6.01 (Vernon); UTAH CODE ANN. § 48-2b-137 (1992); VA. CODE ANN. § 3.1-1046 (Michie Supp. 1992); WYO. STAT. § 17-15-123 (1977).

⁹⁹ *See* Leventon & Schorr, *supra* note 41, at 3.

¹⁰⁰ COLO. REV. STAT. ANN. § 7-80-801 (West Supp. 1991); VA. CODE ANN. § 13.1-1046 (Michie Supp. 1992); WYO. STAT. ANN. § 17-15-123 (1977).

¹⁰¹ FLA. STAT. ANN. § 608.441 (West Supp. 1992); KAN. STAT. ANN. § 17-7622 (Supp. 1991).

¹⁰² UTAH CODE ANN. § 48-2b-137 (1992).

¹⁰³ *See supra* note 30 and accompanying text.

¹⁰⁴ FLA. STAT. ANN. § 608.448 (West Supp. 1992); KAN. STAT. ANN. § 17-7629 (Supp. 1991); UTAH CODE ANN. § 48-2b-142 (1992).

or failed to appoint and maintain a registered agent in the state or to notify the Secretary of State of a change in the registered agent.¹⁰⁵

The remaining four LLC statutes in Nevada, Texas, Virginia, and Wyoming provide no express provision for involuntary dissolution. However, it is likely that provisions such as those given above will be implied to LLCs should disputes ever arise. Logically, such provisions are necessarily implied to provide a check on the LLC's actions to ensure that they do not fall beyond their authorized scope, violate state law, or operate as contrary to public policy.

IV. COMPARING THE LLC TO OTHER FORMS OF BUSINESS ASSOCIATIONS

A. *LLC v. Subchapter S Corporation*

The LLC can be easily compared to an alternate form of business entity, the Subchapter S corporation (S Corp.).¹⁰⁶ The S Corp. is defined by the IRS as an entity which offers the flow-through tax advantages of a partnership to corporations. However, there are several restrictions placed on the S Corp. which are nonexistent for the LLC.

For example, the S Corp. is limited to 35 shareholders.¹⁰⁷ In contrast, there is no maximum limit on the number of shareholders in an LLC, allowing the LLCs to engage in businesses that require a great deal of capital and to expand into larger, interstate, perhaps more efficient, companies.

Also, an S Corp. may have only United States citizens or resident aliens as shareholders¹⁰⁸ whereas LLCs have no such restriction. This advantage allows the LLC to be more competitive in the world markets and attract capital from outside the United States with an internationally recognizable form.

Also important is the possibility that the S Corp. can lose or revoke its limited liability status because it is an elected feature.¹⁰⁹ The LLC's limited liability feature is not an elected feature, and therefore can be considered less risky.

¹⁰⁵ COLO. REV. STAT. ANN. § 7-80-808 (West Supp. 1991).

¹⁰⁶ The IRS defines the S Corp. in I.R.C. §§ 1361-1379 (1992).

¹⁰⁷ I.R.C. § 1361(b)(1)(A) (1992).

¹⁰⁸ I.R.C. § 1361(b)(1)(C) (1992).

¹⁰⁹ I.R.C. § 1362(d) (1992).

Finally, the S Corp. allows only one class of stock whereas the LLC has no such limits.¹¹⁰ This provides the LLC with greater flexibility "in planning distributions and special allocations."¹¹¹ Overall, the LLC has obvious advantages over the S Corp. and it is likely that the latter will pose no serious threat to the development of the LLC.

B. LLC v. Limited Partnerships

Limited partnerships are yet another form of business association relatively similar to the LLC. In the limited partnership, the limited partners have the advantage of limited liability as in the LLC. However, the requirement that there be a general partner subject to unlimited liability¹¹² is the major disadvantage of this form as compared to the LLC. Consider that if the general partner is a corporation, the shareholders of the corporation enjoy the limited liability status,¹¹³ but the corporation itself is faced with unlimited liability to satisfy any debts of the limited partnership. This format gives limited liability to all natural members of the partnership but defeats the flow-through tax advantages of the shareholders in the general partner corporation.¹¹⁴ The LLC, in contrast, gives all of its members limited liability as well as the advantages of flow-through taxation.

Another advantage of the LLC over the limited partnership is the flexibility that the members have in management and control.¹¹⁵ In the limited partnership, too much participation in the management and control of the partnership can result in the partner's forfeiture of limited

¹¹⁰ I.R.C. § 1361(b)(1)(D) (1992).

¹¹¹ John R. Macfield et al., *Colorado's Limited Liability Company Legislation*, 4 PRENTICE HALL L. & BUS. INSIGHTS, June 1990, at 33.

¹¹² See e.g., COLO. REV. STAT. ANN. § 17-61-102 (West Supp. 1991); FLA. STAT. ANN. § 620.125 (West Supp. 1992); NEV. REV. STAT. ANN. § 88.455 (Michie 1991); UTAH CODE ANN. § 48-2a-403 (1992); VA. CODE ANN. § 50-73.29 (Michie 1989); WYO. STAT. § 17-14-503 (1977).

¹¹³ Most states will not disregard the corporate entity in the context of limited liability. However, the Texas Supreme Court has decided otherwise, imposing liability on a corporation created for the purpose of shielding general partners from the liabilities of a limited partnership. *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975).

¹¹⁴ See Fonfara & McCool, *supra* note 14, at 528.

¹¹⁵ LLC members can manage the company "directly" while corporate general partners in limited partnerships must control indirectly through the corporation. See Johnson, *supra* note 17, at 404.

liability.¹¹⁶ However, with the LLC, the members may actively participate in the management and control of the LLC and still receive limited liability protection.

The advantages of the LLC over the limited partnership and the Subchapter S Corporation are remarkable and neither of the old forms should hinder the expansion of the LLC as the preferred form of business association.

V. LLC ISSUES YET TO BE RESOLVED

A. State Court Tax Treatment of LLCs

As noted earlier, the IRS has yet to issue a revenue ruling on the tax classification of LLCs in all states except Wyoming. Thus, classification is the major unresolved issue surrounding the LLCs. However, there is an additional tax issue that could hinder the use of LLCs. The fact that the IRS gives a partnership classification to an LLC does not guarantee that the same LLC will be given partnership status under *state* tax law. If the state tax classifications are inconsistent with the federal classifications, businesses will have additional reasons for hesitating to adopt the LLC form of business association.

Currently, Florida is the only state that specifically provides that LLCs are to be considered and taxed as corporations.¹¹⁷ In contrast, Colorado LLCs are treated as partnerships for state tax purposes if the federal taxation system classifies them as such.¹¹⁸ The remaining states do not expressly discuss the issue.

In a state with a tax law such as Florida's, the legislature has effectively tried to offer the benefits of the LLC form of association yet avoid a major disadvantage. As will be discussed later¹¹⁹ a controversial issue surrounding LLCs is that they will decrease state revenue collected through taxes. In a state with laws similar to Florida's, however, the

¹¹⁶ See e.g., COLO. REV. STAT. ANN. § 17-61-108 (West Supp. 1991); FLA. STAT. ANN. § 620.129 (West Supp. 1992); NEV. REV. STAT. ANN. § 88.430 (Michie 1991); UTAH CODE ANN. § 48-2a-303 (1992); VA. CODE ANN. § 50-73.24 (Michie 1989); WYO. STAT. § 17-14-403 (1977).

¹¹⁷ See FLA. STAT. ANN. §§ 220.02 & 608.471 (West 1989 & Supp. 1992). It seems that legislation was introduced in Florida to correct the disparity between the state and federal tax classifications, however, it was unsuccessful. See Schorr & Leventon, *supra* note 41, at 7.

¹¹⁸ See COLO. REV. STAT. ANN. § 39-22-205 (West Supp. 1991); see also Schorr & Leventon, *supra* note 41, at 7.

¹¹⁹ See *infra* notes 121-23 and accompanying text.

legislature can effectively prevent this revenue loss by treating the LLC as a corporation for state tax purposes and receiving double-taxation revenues. At the same time, they can claim that LLCs in their states have been classified as partnerships for federal tax advantages to attract business to the state.¹²⁰ Such a result seems facially imbalanced in favor of state governments rather than the federal government.

B. *Will LLCs Cost States Tax Revenue?*

As noted earlier,¹²¹ it remains an issue whether the LLCs will cost states revenue in the long run. The basic theory is that with more businesses registering as LLCs rather than corporations, the states' total tax revenues will decline.¹²²

There are several considerations applicable to such a fear. First, the theory assumes that the state classifies its LLCs as partnerships for tax purposes. Second, those rejecting the decreased revenue theory note that most of the businesses that would form LLCs would instead form partnerships rather than corporations, and effectively the tax revenues will remain unaffected with the new LLC form.¹²³ Finally, it should be noted that even if a state receives less corporate revenues due to the growth of the LLC, it should also realize an increase in the overall amount of revenue from partnership status entities, because the LLC Acts will attract business to the state. Of course, the true tax consequences of an LLC Act on state revenue remain to be seen.

C. *Will Interests In LLCs Be Treated As Securities?*

Whether a member's interest in an LLC will be considered a security for state or federal law purposes, or both, is yet another issue to be addressed. The universal rule articulated in *SEC v. Howey*,¹²⁴ determining whether an interest is an investment contract and thereby a security, is applicable here. The critical portion of the test, according to Kansas securities authorities, is the final branch which analyzes whether "management is shared among the members, or whether it is 'centralized in the hands of a select group of managing members.'"¹²⁵ With LLCs this

¹²⁰ See *supra* note 40 and accompanying text.

¹²¹ See *supra* note 119 and accompanying text.

¹²² See *ABA Group*, *supra* note 1, at 1275.

¹²³ See Moskowitz, *supra* note 38, at F14.

¹²⁴ 328 U.S. 293 (1946).

¹²⁵ See *Legislative Briefs, Kansas*, 23 SEC. REG. & LAW REP., 778, 779 (1991). The *Howey* test consists of three prongs: first, is there a contract, transaction or

determination must be made by looking at sometimes unclear statutes and Articles of Organization for particular LLCs. Given the ambiguities involved, this portion of the *Howey* test lacks a precise determination and it remains unclear whether LLC interests are securities.

D. How Will the LLC be Treated in Interstate Commerce?

Given the limited number of states allowing registration and creation of LLCs, it is questionable how LLCs will be treated in interstate commerce. Jurisdictions that do not provide for the LLC entity may not recognize the limited liability for its members.¹²⁶ This risk alone is enough to prohibit large national business from using the LLC form until it becomes more popular and its limited liability receives more security.

In the meantime, the state of Indiana is the only non-LLC Act state which has begun to deal with the problem of foreign LLCs. Although Indiana has no statute allowing the creation of local LLCs, it does provide for the registration of foreign LLCs operating within its borders.¹²⁷ Although this legislation does not provide a complete answer to whether a foreign LLC's limited liability feature will be honored in Indiana,¹²⁸ it does begin to facilitate the operation of LLCs in interstate commerce.

VI. CONCLUSION

LLCs present a challenging, yet exciting, new form of business association for American businesses. Although there are only eight states currently allowing the creation of LLCs, this number will likely increase as the IRS continues to issue favorable LLC tax classification rulings. Due to the newness of this form of business association, there are several unresolved issues surrounding LLCs. However, given the advantages of

scheme whereby a person invests his money in a common enterprise, second, is that person led to expect profit, and third, if so, are the profits to come solely from the efforts of the promoter or a third party. *Howey*, 328 U.S. at 298-99. The third portion of the test must take into consideration the presence or absence of centralized management. If management is centralized, then the interest will, most likely, be considered a security.

¹²⁶ See Mike Higler, *A New Approach to Business; Limited Liability Companies*, 61 INDEPENDENT PETROLEUM ASS'N 21 (April 1991); Schorr & Leventon, *supra* note 41, at 7.

¹²⁷ IND. CODE ANN. § 23-16-10.1-1 (West Supp. 1992).

¹²⁸ The Indiana statute is considered part of the state's limited partnership law. This may indicate that the treatment of "foreign limited partnerships under Indiana law" will guide the approach toward an LLC's limited liability feature. Schorr & Leventon, *supra* note 41, at 7.

favorable taxation, limited liability for members, consistency with the LLC format in foreign countries, and comparative flexibility in management, legislatures and business alike will soon find that the LLC is a viable alternative to the various corporation and partnership forms. In essence, LLCs provide the best of both worlds.

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